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February 23, 1998

*BY HAND DELIVERY*

Ms. Magalie R. Salas  
Secretary  
Federal Communications Commission  
1919 M Street, N. W., Room 222  
Washington, D.C. 20554

**Re: Petition of LCI International Telecom Corp. For Expedited  
Declaratory Rulings, CC Docket 98-5**

Dear Ms. Salas:

On January 22, LCI International Telecom Corp. ("LCI") filed a Petition for Expedited Declaratory Rulings before this Commission (the "Fast Track" proposal). <sup>1/</sup> The LCI petition proposes an alternative "Fast Track" path to expedite residential competition and interLATA entry through establishment of independent RBOC wholesale and retail companies.

On behalf of LCI, I am providing for inclusion in the record in this proceeding copies of the following documents which reflect state-level activity on the issues presented by the LCI petition:

- The petition filed by LCI on January 26 with the New York Public Service Commission asking the New York Commission to open a proceeding to consider LCI's proposal for separation of

<sup>1/</sup> The Commission put the petition out on public notice on January 26, with initial comments to be filed by February 25 and reply comments to be filed by March 27. DA 98-130 (CC Docket No. 98-5), released January 26, 1998. Earlier today, the FCC granted a motion for extension of time for filing initial comments on the petition until March 23.

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Ms. Magalie R. Salas  
Secretary  
February 23, 1998  
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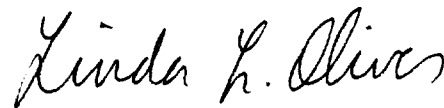
New York Telephone's wholesale and retail functions as a means to expedite residential competition and Section 271 entry.

- The February 18 order of the Illinois Commerce Commission establishing an inquiry to examine "whether, and the extent to which, a separation of Ameritech's retail operation from its network operations could expedite competitive entry in all telecommunications markets, and if so, what types of separations should be considered." Order at 4. The ICC determined that this inquiry was the best means for examining the issues raised by LCI's FCC "Fast Track" petition.
- The February 11 Notice of Inquiry issued by the Oklahoma Commerce Commission seeking comment on how to facilitate meaningful local competition. The Notice includes a series of questions on whether the Oklahoma Commission should "consider incentives for the LEC monopolies to structurally separate their operations." Notice at 4. This inquiry presents questions similar to those raised by the LCI petition.

I have hereby submitted two copies of this notice to the Secretary, as required by the FCC's rules. Please return a date-stamped copy of the enclosed (copy provided).

Please call me if you have any questions.

Sincerely yours,



Linda L. Oliver  
Counsel for LCI International  
Telecom Corp.

Enclosures

cc: Richard Metzger, Chief, Common Carrier Bureau  
Janice Myles

## **CERTIFICATE OF SERVICE**

I, Barbara E. Clocker, hereby certify that on this 23rd day of February, 1998, copies of the foregoing document were served by U.S. Mail, first class postage, or by hand delivery (where indicated) to the following:

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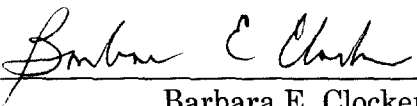
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January 26, 1998

**HAND DELIVERED**

Hon. John C. Crary  
Secretary  
New York State Public  
Service Commission  
Three Empire State Plaza  
Albany, New York 12223

Re: Case 94-C-0095 - Competition II Proceeding - Petition  
of LCI International Telecom Corp. for an Investigation  
into the Expedition of Residential Local Competition  
Through a Restructure of New York Telephone Company  
into Wholesale and Retail Service Companies

Dear Secretary Crary:

Enclosed please find twenty-five copies of a Petition from LCI International Telecom Corp. for an Investigation into the Expedition of Residential Local Competition Through a Restructure of New York Telephone Company Into Wholesale and Retail Service Companies.

The LCI Petition asks that this Commission begin a proceeding for three purposes:

- (a) To adopt the intrastate changes necessary to implement the LCI "Fast Track" plan, a separation of New York Telephone into wholesale and retail entities,
- (b) To investigate how New York Telephone's inter-LATA entry will impact, and necessitate modification of, the Commission's existing regulatory

Hon. John C. Crary  
January 26, 1998  
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requirements to assure that the  
benefits of full service  
competition extend to all  
consumers, and

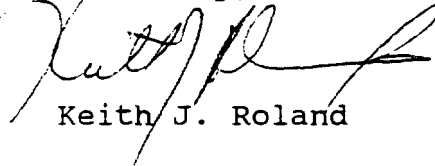
- (c) To explore additional actions that can  
reduce barriers to residential  
competition.

Attached to each copy of this New York State Petition is a copy  
of LCI's "Fast Track" Petition filed at the FCC on January 22,  
1998.

A copy of this Petition is being served on New York Telephone  
Company and upon the active parties to the Competition II  
Proceeding.

All questions should be addressed to the undersigned.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith J. Roland", written over the printed name.

Keith J. Roland

KJR:tlm  
Enclosures  
cc: Competition II Active Parties

FILE COPY

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

Case 94-C-0095 - Proceeding on Motion of the Commission to Examine Issues Related to the Continued Provision of Universal Service and to Develop a Framework for the Transition to Competition in the Local Exchange Market.

Petition of LCI International Telecom Corp. for an Investigation into the Expedition of Residential Local Competition Through a Restructure of New York Telephone Company into Wholesale and Retail Service Companies

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Dated: January 26, 1998

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STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

Case 94-C-0095 -      Proceeding on Motion of the Commission to Examine Issues Related to the Continued Provision of Universal Service and to Develop a Framework for the Transition to Competition in the Local Exchange Market.

Petition of LCI International Telecom Corp. for an Investigation into the Expedition of Residential Local Competition Through a Restructure of New York Telephone Company into Wholesale and Retail Service Companies

TO THE COMMISSION:

LCI International Telecom Corp. ("LCI"), through its attorneys, respectfully petitions this Commission to investigate the regulatory regime that should apply to New York Telephone Company ("New York Telephone" or "NYT") leading to and following interLATA entry in order to expedite residential local competition. In particular, the Commission should pursue steps necessary so that NYT operations can be separated into wholesale and retail components. This separation would address conflicts of interest within the current NYT structure, create meaningful opportunities for residential local competition, thereby accelerate interLATA authority for NYT, and simplify post-entry regulation. The Commission also should make any other adjustments to the regulatory requirements applicable to NYT appropriate to accommodate interLATA entry in a pro-competitive fashion.

LCI is filing this petition (and companion petitions at the Federal Communications Commission and Illinois Commerce Commission) 1/ with the goal of breaking the stalemate that is

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1/ LCI is filing petitions in New York and Illinois because these two states were among the first to begin the process of attempting to create local telephone competition. However, we fully recognize the major efforts of many other state commissions to create meaningful local competition, and encourage them to pursue the same structural solutions to the current stalemate that are discussed

denying consumers -- and especially residential consumers -- the benefits of the Telecommunications Act of 1996. As explained below, the issues raised and the relief sought by this Petition are within this Commission's jurisdiction, are timely, and are crucial to the future of both local exchange and long distance service in this state.

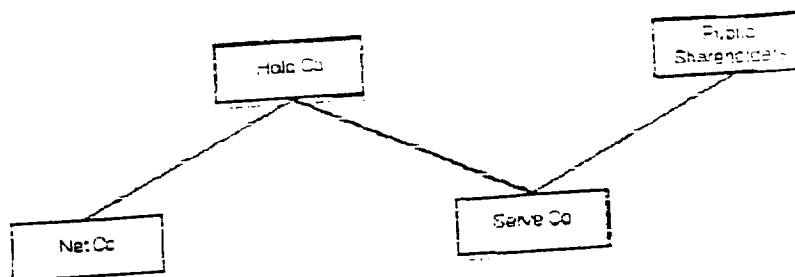
## **I. INTRODUCTION**

New York and the nation stand at the crossroads of a fundamental change in the telecommunications industry. LCI believes that a robustly competitive full service retail marketplace can be created for all consumers -- including, importantly, residential consumers -- built upon the solid foundation of non-discriminatory access by all service providers to the ubiquitous exchange network facilities of the incumbent LEC. Unfortunately, however, we instead are at a point of stalemate. LCI is particularly disappointed by the barriers that are preventing it from serving the local residential market because residential consumers are a particular focus of our business.

To break this stalemate, LCI is proposing a new, coherent, regulatory framework that we call the "Fast Track" plan. Specifically, LCI is proposing a corporate structure that would separate the retail and wholesale activities of New York Telephone Company into two separate subsidiaries. The retail company ("ServeCo") would have substantial public ownership and independent management. ServeCo would interact with the wholesale company ("NetCo") on the same arm's length, non-discriminatory basis, as any other retail service provider.

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here.



The "Fast Track" plan is fundamentally different in crucial respects from other retail/wholesale separation plans that have been designed and, in the case of Rochester Telephone, implemented. It cures the fatal weaknesses in those plans, and importantly, it responds to the much more significant market power of the RBOCs compared to smaller independent ILECs.

LCI has filed a petition concerning "Fast Track" at the FCC because it is directly relevant to matters within the FCC's purview. LCI has asked the FCC to issue declaratory rulings that would apply if RBOC operations are separated in a manner that met the criteria for independence set forth in the plan -- what LCI calls the "seven minimums."<sup>2/</sup> Specifically, the FCC would issue declaratory rulings stating (1) that the RBOC would receive a rebuttable presumption that it has met the requirements of Sections 271 and 272 of the Act and is entitled to interLATA authorization (expediting interLATA entry); (2) that ServeCo would not be treated as a successor and assign under Section 251(h) of the Act (and so not treated as an ILEC); and (3) that ServeCo would be regulated as a non-dominant carrier with respect to its interstate services (the same as a CLEC).

However, "Fast Track" also raises issues for this Commission. Clearly the Commission

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<sup>2/</sup> The seven minimums are set forth at pps. 29-32 of the federal petition.

would need to oversee the separation process itself. Furthermore, the Commission would need to consider adjustments in its regulatory process that would apply so that, as we envision it, the NYT "ServeCo" would be regulated the same as CLECs with respect to its intrastate services. Separation also would be relevant to other matters, such as modifications to current rules that would remain applicable to NetCo.

LCI believes that the "Fast Track" plan would simplify this Commission's regulatory task both before and after interLATA entry. But in any event, interLATA entry will be a watershed event in this state. The time to review and implement the required changes is now, so that there can be a smooth and undelayed transition to the new environment. In addition to the "Fast Track" issues presented here, for example, the Commission may need to address issues and results of previously considered dockets, including New York Telephone's Incentive Regulatory Plan, the contents of tariffs adopted in the Loop Resale Proceeding, the application of the NYNEX/Bell Atlantic merger conditions, and the current Plan governing the relationship between New York Telephone and its existing -- and future -- affiliates. LCI submits that all of these matters will be easier to address if, through separation and independence, conflicts of interests are reduced between NYT's wholesale and retail operations.

We emphasize that this Commission need not feel limited by the "seven minimums" we have identified as necessary to address concerns that arise at the federal level. Importantly, the "Fast Track" plan completely preserves the jurisdiction of states to regulate their own markets pursuant to their own statutory authority. We realize that additional safeguards may be necessary to address local issues under state statutes. For example, the Commission may want to consider whether the "Fast Track" approach should be mandatory for NYT, as well as whether the "seven minimums" we propose are sufficient to address particular concerns here in New York.

In other words, the "Fast Track" plan described in the FCC Petition is designed to provide

a minimum framework that can be used by any RBOC from any part of the country which is willing to help break the current stalemate in exchange for faster interLATA entry and reduced interstate services regulation. But we fully recognize that some state commissions may decide to go further depending upon local conditions and their authority under state law. The groundbreaking actions of certain states to create competition in the electric industry is instructive. Many states are debating, and some are now beginning to take action, to fully divest potentially competitive from non-competitive electric operations to permit competition to have a chance to take root where it can. LCI is well-aware that similar divestiture proposals have been made with respect to the telecommunications industry, and it is not our desire to discourage that debate. At the same time, we are anxious to see the current stalemate is broken quickly so that we have a realistic opportunity to enter local markets -- particularly to offer local service to our residential customer base.

In short, LCI is requesting that this Commission begin a proceeding: (a) to adopt the intrastate changes necessary to implement the LCI "Fast Track" plan, a separation of New York Telephone into wholesale and retail entities, (b) to investigate how RBOC interLATA entry will impact, and necessitate modification of, the Commission's existing regulatory requirements to assure that the benefits of full service competition extend to all consumers, and (c) to explore additional actions that can reduce barriers to residential competition.

LCI believes that if New York Telephone adequately separates its retail and wholesale operations, then consumers -- especially residential consumers -- are likely to enjoy the benefits of the Telecommunications Act quickly. But conversely, if New York Telephone does not adequately separate its retail and wholesale activities, then much more complex regulation -- and the institutionalization of new and specific safeguards -- inevitably will be necessary. The public interest requires these issues to be resolved sooner rather than later.

## II. DESPITE THE COMMISSION'S LONG STANDING EFFORTS, LOCAL COMPETITION HAS NOT REACHED MOST CONSUMERS

LCI has chosen to file this petition, in association with the filings at the FCC and ICC, in recognition of this Commission's historic attempts to create local telephone competition. Importantly, despite the Commission's long-standing efforts, local (and in particular residential) competition has effectively been blocked by New York Telephone within its service area. The Commission therefore is particularly well-suited to consider new ideas to break the current stalemate.

The Commission's pro-competitive efforts began in the 1970s when it adopted liberal interconnection rules to facilitate competition in terminal equipment markets. It later opened up intrastate toll to competition, in both the interLATA and intraLATA markets, through the authorization of resale and the provision of facilities-based services, and was one of the first states to require intraLATA equal access. In the 1980s the Commission authorized competition for facilities-based private line and access services, and expanded that authority to the provision of both resold and competitive facilities-based local exchange service. In the *Competition II* and other proceedings, the Commission has taken further pro-competitive actions.<sup>3/</sup>

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<sup>3/</sup> In the context of the *Competition II* proceeding, and logical outgrowths and extensions thereof, the Commission has considered wide-ranging issues relating to the development of local exchange competition. These have included review of intrastate access charges (Case 28425); development of Open Network Architecture and Comparably Efficient Interconnection (Case 88-C-004); development of cost allocations separating monopoly and competitive services (Case 88-C-063); extension of common carrier concepts to modern telecommunications (Case 89-C-099); unbundling of loops used to provide both business and residential service (Case 91-C-1174); wholesale provisioning of local exchange services for resale (Case 95-C-0657); provisioning of billing and collection services by LECs to third parties (Case 89-C-191); and development of Regulatory Incentive and Open Market plans for New York Telephone (Case 92-C-0665) and Rochester Telephone (Cases 93-C-0103 and 93-C-0033). The Commission has also established a number of vehicles, including the use of its complaint mechanism and the establishment of "ONA task forces," with a goal of providing competitive carriers the facilities and services they require from incumbent LECs to enter the local exchange market. (See Case 88-C-004, "Order Instituting Procedures for the Creation of ONA Task Forces," March 29, 1989).

The transition to local exchange competition has not been smooth, however. Time and time again, incumbent telephone companies, particularly New York Telephone, have fought the Commission and prospective competitors at every step, erecting one roadblock after another to the development of local exchange competition. Illustrative of those roadblocks, but certainly not inclusive, have been New York Telephone's uncompromising opposition to granting central office collocation and, even after such collocation was mandated,<sup>4/</sup> NYT's attempts to impose unjust and unreasonable tariff conditions or its simple failure to provide facilities (such as collocation cages) required by its tariffs. <sup>5/</sup> Even when carriers won the right to obtain services or facilities from New York Telephone, they repeatedly have been forced to file complaints with this Commission because of NYT's inability or unwillingness to provide service in a just, reasonable and non-discriminatory manner as mandated by its tariffs. <sup>6/</sup>

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4/ See Opinion 89-12, Opinion and Order Concerning Regulatory Response to Competition, Case 29469, May 16, 1989, pp. 24-26.

5/ See Cases 29469 and 88-C-004 "Order Accepting in Part and Rejecting in Part Comparably Efficient Interconnection (CEI) Task Force Recommendations", June 7, 1990. *See also* Cases 29469 and 88-C-004 Order Regarding OTIS-II Compliance Filing", May 8, 1991.

6/ See Complaint of Teleport Communications against New York Telephone Company for Failure to Provide Interconnection Service Related to the Digital Transport Facility Associated with FlexPath Digital PBX service, filed in Case 29469, April 24, 1990; Case 95-C-0963. Complaint of Teleport Communications Group, Inc. against New York Telephone Company for Failure to Provide Interconnection Service, filed on October 17, 1995; Case 96-C-0572, Complaints of AT&T Communications of New York, Inc. against New York Telephone Company Concerning Alleged Failure to Provide Just, Adequate and Reasonable Service Quality Standards for the Provisioning and Maintenance of Access Services, filed on June 24, 1996, in Case 92-C-0665; Case 97-C-1532, Complaint of Teleport Communications Group, Inc. against New York Telephone Company for Failure to Provide 64 Clear Channel ISDN Service and Facilities, filed September 8, 1997; Case 92-C-0685, Complaint of Centex Telemanagement, Inc. against New York Telephone Company for Refusal to Provide Wire Center Number Retention Service, November 4, 1991; Case 97-C-0907, Complaint of Independent Payphone Association of New York against New York Telephone Company Regarding Curbside Payphone Installations, May 12, 1997; Case 94-C-0577, Petition of ACC Syracuse Telecom Corp. for the Creation of an ONA Task Force to Address Technical and Economic Issues Relating to ACC's Request for Collocation and Related Services from New York Telephone Company of July 22, 1994; Case 96-C-0693, Complaint of ACC National Telecom Corp.

New York Telephone's unacceptable conduct has not been limited to its efforts to block competition in the local market. In the intraLATA toll market, Commission intervention has been required to, among other things, prohibit unfair intraLATA PIC change practices <sup>7/</sup> and eliminate below cost pricing for competitive intraLATA toll plans. <sup>8/</sup>

Aside from purely competitive issues, this Commission has been confronted with numerous instances of improper transactions between New York Telephone Company and its affiliates, which resulted in excessive rates being charged to the Company's general body of ratepayers. <sup>9/</sup> The revelations from those inquiries led to the establishment of Case 91-C-0102, which was instituted to investigate the corporate structure of New York Telephone and its affiliates, including whether the Company's conduct had been so culpable as to justify divestiture of New York Telephone from its then-parent NYNEX Corp.

All of this past conduct, and New York Telephone's current treatment of its competitors and customers, has come to the fore in connection with the Section 271 proceeding (Case 97-C-0271) conducted during 1997. There New York Telephone has attempted to demonstrate that it has opened its local telecommunications market to competition. But that proceeding actually has turned into a demonstration of the opposite: that the local exchange market in New York remains a monopoly,

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against New York Telephone Company Concerning Alleged Inferior Service Quality, July 11, 1996.

<sup>7/</sup> See Cases 28425, et al., "Order Concerning Implementation of Intra-LATA Presubscription by New York Telephone Company", August 15, 1996.

<sup>8/</sup> See Case 92-C-0665, "Order Requiring Utility to Show Cause, Requesting Comments and Granting Rehearing in Part", May 27, 1997.

<sup>9/</sup> See, Case 90-C-0191 -- Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York Telephone Company; Case 90-C-0912 -- Proceeding on Motion of the Commission to Investigate Transactions Among New York Telephone Company and Its Affiliates.

primarily as a result of New York Telephone's failure to comply with its statutory obligations to open its network to other carriers. What has emerged is a disturbing picture of New York Telephone's desire to keep its local markets closed, and to enhance its competitive standing at the expense of its potential rivals.

### **III. LCI'S "FAST TRACK SEPARATION PROPOSAL"**

LCI believes the core reason the local exchange market has not been opened to significant competition, particularly residential competition, is the conflicting incentives facing New York Telephone as a provider of both wholesale services to its competitors and retail services to its own customers. As discussed in the attached federal petition, it is that fundamental conflict of interest that has made progress to full local competition (and Section 271 compliance) so slow.

In the past, this Commission has considered divestiture as an appropriate remedy to eliminate the motivations and incentives which lead to unacceptable corporate behavior. The time has come again to consider a serious structural approach, such as the one described by LCI, as a means to assure that New York Telephone provides just, adequate and reasonable service, in a non-discriminatory and non-preferential manner, to customers and competitors alike in this State.

The details of LCI's "Fast Track" proposal are spelled out in the petition it has filed with the FCC, a copy of which is attached. The thrust of the FCC Petition, like this one, is that the 1996 Act's promise of local competition has not been realized. Three principal barriers to local competition lie at the heart of the problem: (i) operations support systems (OSS); (ii) availability of unbundled network elements (UNEs); and (iii) pricing. Those problems share a common thread in that they have become more complex and difficult because of the conflict of interest between an RBOC's dual role as both network supplier and service provider. Any incentive that the RBOC has to sell use of its local facilities network to CLECs is counteracted by the fact that, by doing so, the RBOC's retail

operations will lose customers.

To reduce those conflicts, LCI is proposing a corporate structure that would fully separate RBOC retail and wholesale activities into independent subsidiaries, one of which -- ServeCo -- would have 40% or more public ownership and independent management. Retail activities, including both local and toll, would be housed in "ServeCo," while NYT's existing network facilities would be owned by the wholesale affiliate known as "NetCo." ServeCo would interact with NetCo in exactly the same manner as if it were an unaffiliated CLEC.<sup>10</sup> As outlined in LCI's federal petition, in exchange for adopting this corporate structure, the RBOC would be entitled to a rebuttable presumption that it has met the requirements of the Section 271 competitive checklist and the Section 271 public interest test. ServeCo also would be entitled to unregulated treatment for its interstate services, and, subject to decisions made by this Commission, its intrastate services would be regulated the same as other CLECs.

LCI refers the Commission to the very detailed specifications of the "Fast Track" plan presented in the attached federal petition. There we fully explain the functions of NetCo and ServeCo, the manner in which those companies will deal with each other, and the treatment of NetCo's embedded base of customers (including the process by which ServeCo and other CLECs would compete to win those customers prior to balloting and allocation). We discuss universal service and network integrity issues. We explain when the structure would sunset.

Furthermore, we discuss in the federal petition the many public interest benefits that would flow from the "Fast Track" plan -- and from the reduction in RBOC conflicts of interest that would result. For example, this Commission will recognize quickly that separation would reduce the level of regulation required in the future, particularly in the retail market. By limiting the ability of

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<sup>10</sup> / The proposal is described in detail in the attached federal petition.

NetCo to discriminate in favor of ServeCo, the plan eliminates the need to scrutinize ServeCo retail rates closely for evidence of discrimination.

Regulation of NetCo will continue to be necessary to prevent it from exploiting its monopoly through non-cost-based prices for wholesale network inputs charged to all CLECs, including ServeCo. The Commission also will need to ensure that NetCo does not block the development of competing facilities networks that may eventually erode NetCo's dominance. For example, NetCo still will have incentives to deny reasonable interconnection to other networks, whether those of ServeCo or another CLEC. However, the "Fast Track" proposal does nothing to increase this concern, and the inevitable introduction of new facilities by ServeCo should bring beneficial incentives to interconnection in the same way we expect our plan to accelerate retail competition.

Overall, "Fast Track" (i) creates conditions for meaningful retail competition by limiting RBOC discrimination in favor of itself; (ii) insulates retail competition from the consequences of excessive NetCo pricing so that such competition can proceed with minimal regulation; (iii) makes it easier for regulators to identify any anti-competitive conduct by NetCo; and (iv) allows this Commission's limited regulatory resources to be focused on creating facilities competition that eventually will allow "fast track"-style separation and related regulation to sunset.

#### **IV. THE COMMISSION SHOULD CONSIDER A STRUCTURAL APPROACH IN NEW YORK**

##### **A. "Fast Track" Is Anticipated By Prior Commission Telecommunications Proceedings.**

LCI's proposal is a vehicle to correct the lack of effective local exchange competition existing in New York, notwithstanding the pro-competitive policies which have been enunciated by this Commission for over twenty years. Unfortunately, the traditional methods of obtaining compliance with Commission directives and policy, including rate case adjustments, establishment of tariffs which

require pro-competitive conduct, and the resolution of specific complaints, simply have not been sufficient to modify either New York Telephone's corporate attitude or its actual conduct towards its competitors. The time has thus come for consideration of a more comprehensive, structural approach to resolving the deep rooted problems which are preventing the development of local exchange competition -- and are likely to hinder competition in expanded toll markets -- in this State.

Consideration of structural approaches to regulatory problems is not novel in this State. In July, 1988, the Staff of the Department of Public Service issued a study of New York Telephone Company's purchase and procurement practices through its affiliate NYNEX Material Enterprises Company (MECO). That study, among other things, recommended an examination of the relationship between New York Telephone and its Affiliates; that MECO's profits on transactions with New York Telephone be reduced; and that MECO be established as a subsidiary of New York Telephone rather than as an affiliate owned by NYNEX. Subsequently, further evidence emerged as to improper practices of New York Telephone employees, and the relationship and transactions between New York Telephone and its affiliates. In response to those new developments, the Office of General Counsel initiated an investigation into the business practices of MECO and one of its former officers.

In making recommendations to the Commission, General Counsel recited the past history of the Commission's active regulatory investigations of issues "directly related to the NYNEX corporate structure and the incentives it created for conduct inimical to ratepayer interests." General Counsel noted that since 1984, when NYNEX was formed as a result of the AT&T divestiture decree, "the Commission has been actively challenging NYNEX affiliate activities that seemed motivated primarily to enhance the holding company's corporate profits at the expense of the regulated telephone company's ratepayers." He also noted that "each Commission investigation has met with strong resistance by the telephone company and its corporate parent."

After analyzing a number of the serious incidents of misconduct by NYNEX, New York Telephone and its affiliates, General Counsel concluded as follows:

The holding company problems identified here and in the previous staff reports strongly suggest the need for a fundamental restructuring of the NYNEX/New York Telephone Company relationship. It appears to me that ratepayers would be best served by a regulated telephone company that was divested from or became a fully separated subsidiary of NYNEX. I recommend that the Commission initiate a comprehensive study of the NYNEX Corporation's corporate structure and its relationship with New York Telephone Company in light of the opportunities for abuse apparent in the corporation's existing organization. The manner in which this corporation has handled itself since divestiture in 1984 raises serious and troubling questions about its management agenda, its business purposes, and the future direction in which it will lead New York Telephone Company unless changes are made. In addition to complete analysis of the holding company's corporate relationship with New York Telephone Company, this study should examine the NYNEX Corporation's current structure, and the full range of reasonable alternatives, including possible divestiture of New York Telephone Company from the regional holding company, to determine what structure will best protect ratepayer interests. 11/

Based upon the Cowan Report, and problems pointed out by parties in the then-pending New York Telephone rate case, this Commission issued an Order on November 26, 1990, directing a further investigation into New York Telephone's activities:

The further investigation should examine not only the costs that may have been imposed on ratepayers thus far, but also the prospective remedies, including a possible reorganization of NYNEX's corporate structure, that may be warranted to prevent abuses in the future. These two broad areas of inquiry should be pursued separately. 12/

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11/ Cowan Report, pp. 61-62.

12/ Cases 90-C-0191 and 90-C-0912, "Order Granting Interlocutory Appeal in Part", issued and effective November 26, 1990, at pg. 6.

The Commission further ordered that its investigation be broad and that it explore the corporate structure of NYNEX and its affiliate relations:

All holding company controls, policies and directives to New York Telephone and intra-NYNEX transactions associated with New York Telephone will be investigated to determine the reasonableness of an alternate corporate structure, including possible divestiture of New York telephone from the regional holding Company. 13/

NYT proposed a settlement of the matter, which was acceptable to the Commission, that included some restructuring but did not include divestiture of NYT from NYNEX. 14/ But, even though the Commission ultimately determined not to mandate a divestiture and restructuring, it made clear it was prepared to take such action if necessary to assure compliance by New York Telephone with its statutory and regulatory obligations.

This Commission has also considered a voluntary initiative by an incumbent local telephone company to restructure itself into wholesale and retail affiliates. Specifically, in the context of Cases 93-C-0103 and 93-C-0033, the Commission considered an "Open Market Plan" proposed by Rochester Telephone, pursuant to which RTC would restructure itself into a regulated wholesale provider of telephone services ("R-NET"), and a lightly regulated retail provider of competitive telephone goods and services ("R-COM"). 15/

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13/ Order Granting Interlocutory Appeal in Part, November 26, 1990, pg. 8.

14/ Case 91-C-0102, Opinion and Order Suspending Investigation", Opinion 92-10, April 24, 1992.

15/ One major difference between the RTC proposal and that put forth by LCI is that all of the shares of both R-NET and R-COM would be owned by Rochester Telephone as the holding company parent. In contrast, under LCI's proposal, a minority interest in the shares of "ServeCo," which is comparable to RTC's "R-COM," would be owned by the public. Another major difference is that unlike Rochester's network company ("R-Net"), the network company in the LCI proposal ("NetCo") would no longer market retail services after the restructure nor be permitted to provide to new customers or customers who have moved to a new location.

The Commission ultimately declined to accept the restructure proposal as put forth by Rochester because of a number of concerns, including the mandatory transfer of all retail customers from R-NET. The latter concern is not raised by LCI's Petition, because LCI proposes that the wholesale company be allowed to continue providing service to existing customers during a transition period. That would avoid any sudden confusion or disruption in the market, and obviate the immediate need for implementing a balloting system which would force existing customers to choose a different carrier.

The very fact that the Commission, and the parties to the RTC Open Market Proceeding, devoted so much time and attention to RTC's proposal confirms that separation into wholesale and retail providers has substantial merit, and if properly designed, would be an effective mechanism to open local exchange markets to competition. 16/

**B. "Fast Track" Is Consistent with Commission Practices in an Analogous Industry.**

Finally, in the context of another industry, this Commission has determined that competition, consumer welfare, and the public interest would be advanced by separating a previously integrated industry into wholesale and retail components. The analogy, of course, is to the electric and natural gas industries in this state, where this Commission has promoted competition by directing a restructure into separate "supply" and "distribution" entities from what were previously integrated monopoly utilities. *See* Case 94-E-0952, *In the Matter of Competitive Opportunities Regarding Electric Service*, Opinion 96-12, May 20, 1996; Case 93-G-0932, *Restructuring of the Emerging Competitive Natural Gas Market*.

On the electric side, the utilities have been directed to submit their plans for a restructure

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16/ The Rochester plan did not have this positive effect on competition and consumer choice, however, because it was not a real wholesale/retail split, and because the holding company continued to fully own both companies.

involving the separation of generation from transmission and distribution, with a preference for divestiture:

In a wholesale or retail competitive model, generation and energy service functions should be separated from transmission and distribution systems in order to prevent the onset of vertical market power. Total divestiture of generation would accomplish this most effectively and is encouraged. As to energy services, to the extent that divestiture will provide consumer benefits (lower rates, increased choice, and reduced likelihood of market power abuse), divestiture of this function is encouraged.

Opinion 96-12, Case 94-E-0942, *supra*, at pp. 90-91. *See also* Case 96-E-0891, *In the Matter of New York State Electric and Gas Corporation's Plans for Electric Rates/Restructuring Plans Pursuant to Opinion 96-12*, Recommended Decision by Administrative Law Judge Jeffrey E. Stockholm, December 3, 1997; Case 96-E-0897, *Consolidated Edison -- Electric Rate/Restructuring*, Opinion 96-16, issued November 3, 1997.

While the Commission chose not to order divestiture immediately, it preserved its authority to do so -- authority which has been confirmed by the State Supreme Court. *See Matter of The Energy Association of New York et al. v. PSC*, 169 M2d 924 (Nov. 1996) (appeal pending).<sup>17/</sup>

Similarly, with respect to natural gas, for more than a year gas customers have had the opportunity to purchase natural gas from independent marketers, with utilities merely transporting the competitors' natural gas over their local distribution facilities. *See* Case 93-G-0932, *supra*.

Under these policies, the wholesale and retail functions which previously had been bundled into one monopoly provider have now been separated. The bottleneck facilities which, in the case of electric and gas, are the local distribution facilities, remain regulated in one entity, and the

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<sup>17/</sup> To date, each utility plan approved by the Commission has included full divestiture of generating capacity.

competitive aspects of the business have been moved into separate deregulated or lightly regulated entities.

Many observers suggest that the deregulation of the telecommunications industry over the last decade has been the model for deregulation of the electric and natural gas industries. But it is also the current restructure of the electric and gas industries into wholesale and retail components which can serve as a model for a restructure of the dominant player in the telecommunications industry -- New York Telephone -- to further the goals of opening the local telecommunications market to competition - especially for residential customers - and speeding the day when New York Telephone can begin providing interLATA services. 18/

**V. ANTI-COMPETITIVE CONDUCT BROUGHT TO LIGHT IN THE SECTION 271 PROCEEDING REQUIRES CONSIDERATION OF A RESTRUCTURE OF NEW YORK TELEPHONE INTO WHOLESALE AND RETAIL COMPONENTS**

During the recently completed technical conference in Case 97-C-0271 (New York Telephone's Section 271 Petition proceeding), dramatic evidence was produced demonstrating that New York Telephone had not only failed to meet the requirements of the Section 271 checklist, but also that New York Telephone had, over the years, engaged in numerous acts of anti-competitive conduct which had the effect of hindering its competitors from entering the local exchange market. This evidence shows that New York Telephone's underlying conflict of interest has driven it to resist the reasonable requests of its carrier-customers for interconnection and to attempt to impede their ability to employ New York Telephone's network to provide competing retail services. It is not behaving, in short, like a company that wants the business of its carrier-customers.

**A. NYT's OSS Shortfalls.**

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18/ We recognize that analogies to electric and gas industries are not exact. For example, over time duplicate local exchange networks may be constructed. But such duplicate local networks are still far from a reality, especially for residential customers. As noted above, LCI's structural plan would sunset when such local facilities exist.